FT interview transcript: Arunma Oteh

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As Nigeria's new securities regulator, Arunma Oteh has a tough task ahead of her. Africa's second-biggest stock market is struggling to recover from a crash that has wiped $50bn off its market capitalisation from its March 2008 peak. Allegations of foul play abound – to be probed in the investigation Ms Oteh has ordered.

In her first interview with a foreign media organisation since taking up her post as director general of the Securities and Exchange Commission at the start of the year, Ms Oteh tells Tom Burgis, the FT's West Africa correspondent, of her "transformation agenda".

Speaking in Lagos, Nigeria's commercial capital, on Friday March 5, 2010, she details the allegations of malpractice by brokers, her wide-ranging plans for reform and how she believes a functioning capital market could help to unlock the potential of Africa's most populous nation. Below is an edited transcript.

Financial Times: For two years there have been spectacular tales of huge losses, a huge bubble on what was regarded as one of the world's most attractive frontier markets. As you take over, what's the nature of the task ahead of you?

Arunma Oteh: First, the way that I perceive the task ahead of me is really to ensure that the markets fully support Nigeria in realising its potential, and therefore that the market's a world class market, by any standards, and that means that in every sense of the word it's best practice, best practice.

For any country I do feel strongly that capital markets are extremely important, but more so for Nigeria than any other, because it's almost been 50 years since independence, and we're still very much dependent on oil as our primary source of revenues. Oil makes up 80 per cent of Nigeria's revenues, 90 per cent of its export revenues.

My country is a country where the entrepreneurial spirit is just outstanding. You've got really hard-working people who are keen to make a difference in many ways, and the capital markets provide the opportunity for people to raise capital and for people to also invest in the market. So my vision is that it has to be a market that is the first port of call for a local investor and the first port of call for an international investor. It has to be one that helps us address the huge development challenges that we face.

The current administration of President [Umaru] Yar'Adua has been very focused on the importance of infrastructure. If you look at Nigeria's GDP, give or take $200bn, capital formation should be about 17 per cent, so that's give or take $34bn. So you should expect infrastructure spending and investment by the private sector every year to be about $34bn. We're nowhere near that. While the capital markets can provide, for the sovereign, for the sub-sovereign, for the state government, opportunities for them to raise money, it's not doing that [sufficiently].

Our markets have been predominantly equities driven, and even in addition to being equities driven, with the consolidation that happened in the banking sector, it's been primarily driven by the banking sector. So where the markets have gone the last three years have been where the banking sector has gone.

The bank stocks are about 60 per cent of the market. There are a little over 200 securities that are listed on the Nigerian Stock Exchange. The market cap right now is give or take 5 trillion [naira], from about 12.5 to 13 trillion at its peak in March of 2008, so you've seen a 7 trillion erosion in value, a lot of it driven by what has happened in the banking sector, and a lot of it driven by some of the weaknesses that come from not having laid a solid foundation, in terms of a capital market.

Therefore my vision is a market that is stable, that is efficient, one that helps Nigeria fund its huge needs, one that is considered world class by any investor, local or international. Therefore my first priority is to build investor confidence on a solid foundation, and I believe that the challenges we've had over the last two years allow us to do that because we can learn lessons from what I see has been a result of weaknesses in governance and also capacity: capacity at the level of regulators, capacity of capital market operators, and capacity at the level of the ordinary investor.

A one-directional casino

Over the last few years, my understanding is that we've seen significant interest from retail investors in our equity market. Unfortunately that interest was driven, initially, by misrepresentations about investing in our markets, which I would describe as people assuming that this was a one-directional kind of casino, where, if you invested you would basically have your funds grow. I do think that a lot of retail investors looked at this market like a savings account, at best – a savings account where you invested and at the end of a period you would get some more money into your account.

FT: But they were invited to think like that.

AO: Oh, absolutely. Because of misrepresentations by capital market operators, by everyone, I would say, in the market, including ourselves as regulators. And therefore, while we've seen a significant erosion in value, with the 7 trillion loss in our market, it's also allowed everyone to look at the market and try to better understand what the issues are.

FT: Could you sketch those?

AO: First, as I mentioned, the real capacity issues. Capacity is an understanding of the risks of investing in the market, an understanding of the products available in the market, an understanding of the role of different players. So I can give an example in terms of some of my early observations: something as basic as not understanding the value of having custodians. You had, in my understanding, in the last two years, some broker dealers, or some brokers, who were commingling their own assets with the assets of clients.

Secondly, and I think most significantly, is what had happened in margin lending. My understanding is that there were no guidelines for margin lending. In some jurisdictions that I've been exposed to there are equities that are not marginable, so in some jurisdictions, bank stocks are not marginable, but in our country a lot of the margin lending happened with bank stocks, and part of it was the drive towards ensuring that banks had the minimum capital that was required.

FT: So people were effectively manipulating those stocks?

AO: Well, there have been allegations about share price manipulation. There have also been allegations about insider dealing. In fact, the SEC is currently going through the investigations to establish what actually happened with respect to that, and this will complement the audits that the central bank has already done.

A probe into alleged “impunity and recklessness”

FT: People in the market are aware that this investigation’s going on. Is that your first task?

AO: It’s one of my many first tasks. The reason I consider it an extremely important task is that we at the SEC believe we have to have zero tolerance for anything that’s improper in the capital market, because the capital markets are built on trust.

An investor puts money in the market with the expectation that what happens to that money depends on the investment decisions that he’s made – the outcome is not dependent on improper behaviour. And therefore for us to truly send the signal that this is a market that is world class, which should be the first port of call for any investor, we must send the signal that improper behaviour is unacceptable. And that’s why I consider this an extremely important task, and that’s why the investigations are extremely important.

FT: You’re investigating whom, exactly? The brokers? Everybody who plays in the market?

AO: Primarily the capital market operators, so the brokers, the registrars, the trustees, asset managers. And our investigations are driven by complaints, by our own observations, by market surveillance that we do, and in terms of priorities, as I said, given what has happened in the banking sector, given that 60 per cent of the market cap is really attributable to banking stocks.

Given the work that the central bank has recently done [an emergency audit that found nine banks so weak they needed a $4bn bail-out], it makes sense that we complement that work and complete the investigations, primarily because a number of the observations from the central bank have been capital markets related because it was primarily driven by the interest of banks to meet the minimum capital requirement.

[The banks] needed to make sure that they had the capital to do the things that they had committed to do. A lot of them raised equity. A lot of them merged. I mean, the consolidation [of 2004] had many aspects to it. But there was no excuse to inflate equity or manipulate share prices.

At this point in time, there are allegations, which are investigated. I mean, SEC has a very vigorous, elaborate process for completing investigations but the sense that I’ve got in the short time that I’ve been here is that some of the allegations about share price manipulation may be right, but I’m not able, at this point, given that we’re in the middle of our investigations [to say more].

FT: How long do you think they will take?

AO: We’ve got a very rigorous process that includes an administrative procedure, committee process, which allows the parties in question to respond to some of the observations.

We have teams that go to the banks, to the broker dealers, and carry out their investigations. When those are completed there’s an administrative proceedings committee that then handles hearings related to that. And that’s then considered by the board of the SEC. Where there’s civil action we work with the Investment and Securities Tribunal, which is the specialised civil court that was set up for that purpose.

For criminal wrongdoing we work closely with the criminal authorities notably the EFCC [the Economic and Financial Crimes Commission] who’s an important partner for us.

You must send a signal that improper behaviour is not permissible and that the culture of impunity and recklessness which I understand is one that's been associated with our markets in the last two years will not continue and is not acceptable.

The Investment and Securities Act gives us enough leverage to make sure the personal cost and the cost to the institutions associated with anything improper is so high that it deters any other person from considering doing things that are improper. And that's why any wrongdoing must be brought to book.

FT: You can impose those fines yourself?

AO: Yes we can. That's why our investigations must be thorough. That's why it's important that people feel comfortable bringing complaints to ourselves.

FT: Is this a case or weeks, months, years?

AO: It depends on the nature of the infraction. There are infractions where we can conduct our investigations very quickly. There are others that take quite some time. There are some things we've concluded in the past within a week, there are others that have taken a year or two to conclude. But for the ones that relate to the challenges we've had in the market I have a keen interest to make sure that we conclude them as quickly as possible.

Of course, given our interest in sending a very strong signal about doing things right and doing things in line with best practice, it's also very important that even the investigations are done properly, that they are thorough and that we follow due process.

We're trying very hard to move as quickly as possible with our investigations, particularly with the respect to the work that the central bank has already done in terms of its audit. If it takes too long, then it's not as useful to the market.

FT: Lamido Sanusi [the central bank governor] told us in December that his asset management company would deal with not all but a large chunk of the toxic assets relating to stock-related lending and other things. He thinks that could be as much as a trillion naira. We've been talking about this 7 trillion naira loss [at the stock exchange]. And some people in the market think that there could be $5bn to $10bn of losses sitting with the brokers and the other players. Do you have a sense of the permanent losses in the system? A lot of people think that all or almost all brokers are effectively insolvent.

AO: As I mentioned, at its peak our market cap was about 12.5 to 13 trillion [naira], so that's about $100bn. More recently the market cap is left at about 5 trillion, give or take, so there's been a 7 trillion erosion in value. Based on my preliminary assessment of the market, we've probably got about 40 per cent of market cap which people intend to buy and hold, both retail and institutional investors. Therefore my sense – and this is really back of the envelope – is that 20 per cent of the market cap is probably what you had in terms of proprietary trading between banks and brokers. So the estimate you have from the central bank of about a trillion does make sense. It's likely that it could be higher.

Until we complete our investigations of 300-odd brokers it would be not proper of me to give a firm estimate but there are clearly indications that a number of the brokers, given the size of their exposure to margin lending, should have a negative net worth.

FT: One banker I was speaking to said you'd have to be insane to put new money into the market at the moment.

AO: We've had a situation that's unusual worldwide. That said, in the seven weeks that I've been in this role based on the feedback that I've gotten from my colleagues, there are brokers who have done things right in this market. There are others who were speculative, who focused more on their dealer role, on proprietary trading, and it's likely that they have a negative net worth today. Therefore having a broad-brush approach would not be appropriate.

But what's also important is putting in place a culture of best practice. I was shocked that there isn't a culture of having custodians. I understand that we have some brokers who are actually holding the assets that they trade. As a result of that there's been co-mingling of their own assets with assets of clients. That's not best practice. That has to change as quickly as possible because that sends a signal that our practices are world class. We've got a central depository which needs to play a more important role in this regard. Assets are recorded by brokers. What I would expect is that they would be recorded on the basis of the individual shareholder's exposure.

FT: What about capital requirements for brokers?

AO: There's clearly a need to review the capital requirements of brokers. The SEC made some proposals two or three years ago about what would be appropriate for different categories of brokers, different players in the capital markets. We're revisiting the proposals that were made because we do believe it's important that brokers, issuing houses have adequate capital. That allows them to ensure that they have the right infrastructure.

We're also interested in what I would call "integrity capital". We have rules that say you should have two licensed brokers in a company. But everyone who is involved in the brokerage business should have the expertise.

FT: Be certified?

AO: Absolutely. So one of the things we're looking at it a certification programme – but one where we're not reinventing the wheel. We're looking at way to get stockbrokers to partner with international, worldwide recognised bodies.

FT: In general, have you been working with the SEC in the states or the FSA in London?

AO: Indeed. One of the first things I am doing is to ask for a peer review by the US SEC. They've accepted. They will come at the end of this month to give me a sense of the gaps. They are bringing a team that includes a broker dealer oversight expert, exchange experts, enforcement experts and investigation experts.

FT: Are they going to help with the investigation as well?

AO: They will assess what we're doing on the investigation. It would be great if they could help but I guess every agency has its capacity issues. But they've been kind enough to give me an assessment of where the gaps are and possibly make recommendations on what I can do to address those gaps. Later on in the year they will do a much larger examination and provide some training.

FT: Are you sure that after your investigation there will be enough brokers left to get the market going again?

AO: We have 300-odd brokers.

FT: But maybe 25 significant ones?

AO: Yes. But it's 300-odd brokers doing exactly the same thing with the same capital requirement. My visions of where we would go is that we work on a risk-based approach for capital requirements [and have] fewer, professional dealers. There is either a consolidation or people can meet the capital requirements that we expect from them going forward.

Toxic assets

FT: The AMC [the planned Asset Management Company to buy up toxic assets that is currently before legislators]. Does that help to solve the problem?

AO: My view of the asset management company – and we at the SEC have been working very closely [with the central bank and finance ministry] – is that it is very useful. Because what is happening today is that whenever it appears that there's some recovery in the market, banks and brokers dump shares so they can meet their obligations. What we would like is to have an orderly off-loading of the toxic assets. That's what an asset management company will help do.

FT: So it takes the margin loans but also the underlying stock?

AO: Absolutely. Some of the brokers, they've been assessed as being professional. They have been involved in the speculation but not from the point of view of things that are improper can focus on their business of being brokers rather than focusing on trying to just meet their obligations that come due on outstanding margin loans.

The recovery in my view has already begun. After the results of the audit by the central bank, people could distinguish between non-bank stocks, stocks focused on fundamentals, and secondly between the good banks and banks [where the central bank intervened]. There is the value of information. People are focusing on fundamentals.

FT: Liquidity is still very low.

AO: When you look at the daily turnovers they've been between about 2.5bn naira and 5bn naira since the beginning of the year. So they've been relatively low. But there is scope for liquidity to evolve.

FT: And liquidity is to some extent a factor of confidence.

AO: Absolutely. That's why the signals that we send – that things that are improper will not be accepted, that the investigations are going to come up with findings and people will have to pay the penalties – for me are just as important if not more important than some of the more quantitative indicators.

A broad front

FT: And you are working with Lamido Sanusi [the reforming central bank governor].

AO: It's very important that regulators work closely together. The central bank governor and I have been living up to that expectation. We're on SMS [text message], we speak with each other. We're doing a joint investigation – some of the investigations are joint because we're leveraging the work that his team has done.

FT: Is this the start of a broad reform agenda in financial services?

AO: I don't think we have a choice.

FT: How about with the Nigerian Stock Exchange [whose management has been broadly criticised]?

AO: Our relationship is exactly what it should be which is of us as an apex regulator and an understanding of the value of them working very closely with us. We are in touch often about issues. We have recently completed our preliminary review of the NSE. We've sent the result of our finding to the NSE.

FT: Is there a need for change?

AO: There's a need for changes everywhere given the experience we've had over the past two years. There's a clear belief that we need to learned from the lessons of the past.

FT: Did you have to clarify the nature of the relationship between regulator and stock exchange?

AO: I think that had been clarified before I arrived but I've been reinforcing the importance of recognising our role as the apex regulator. There is a clear understanding, because I think public opinion is on the side of having a regulator like SEC playing its role fully.

FT: Do you think you are likely to encounter resistance to your reforms?

AO: My sense is that people who have benefited from the status quo will resist change. But the advantage I have that others may not have had in the past is that public opinion is with change and reforms in the capital markets. The reason is that everybody has seen the consequences of some of the challenges that we've had.

A friend – he's a capital market expert – told me that his chauffeur said to him that this bank stock is the right stock to invest in. People understand that we must do things right and lay a solid foundation. The market is clearly not a one-directional casino which was the impression that was created. One aspect of my agenda is focusing more on educating the average investor, first on what the capital markets mean and investing in the capital markets, what their rights are and what the role of a regulator is. You can't have a market that flourishes without investors who can trust a market or if they're not informed.

A transformation agenda

FT: If those are the problems, what would you say is your broad agenda?

AO: My agenda is a reform agenda, what I would call a transformation agenda, such that our capital markets are able to play the role that it should play in ensuring that the full potential of our economy is realised.

The elements of that agenda relate to trust, building investor confidence. And building investor confidence means ensuring that sharp practices are not associated with this market. Also that there is capacity at every level, at the level of investors, at the level of capital market operators and at our own level as regulators. The other aspects of that agenda relate to deepening and broadening the capital market. And also just raising the level such that it's more sophisticated, focusing on fixed income securities because it makes a small proportion of our capital markets while there's a real opportunity to do much more.

Secondly, ensuring that products that are useful. I mention collective investment schemes. I think they're extremely critical because of the interest of retail investors in our markets. They leverage professional expertise as they invest in the market. So promoting collective investments is extremely critical for me, promoting hedging instruments is critical. Clearly we need to broaden and deepen our market, making sure that it's cost effective and efficient to issue and invest and in these markets. Third, that the disclosure regime is enhanced: that it's transparent and there's more accountability. And that we abide by international standards.

I think what I would like my legacy to be is that this is a market that has the highest standards in terms of corporate governance. That has the highest standards in terms of the disclosure regime. And so I support strongly the implementation of international financial reporting standards. There is a National Accounting Standards Board that gives guidance on what should be the standards, gives guidance on enforcing the standards. And we're actually at the SEC working very closely with the National Accounting Standards Board on a roadmap for the implementation of International Financial Reporting Standards. We have a timetable. Our expectation is that by 2013 all banks and all listed companies [will be on IFRS]. What it does is that when an investor sees the financials, because it's compliant with IFRS, they feel comfortable.

The other thing is of course to be more effective as a regulator. That's key and that means issues around our own capacity. We need to leverage technology much more. We need to partner with other regulators. I'm very keen to further the multi-lateral memorandum of understanding that we've established with other IOSCO members, the International Organisation of Securities Commissions.

I've got some other agendas which are not an immediate priority given the things that I need to be focusing on Nigeria. The stock exchanges in West Africa are already working towards regional integration in terms of a platform, in terms of infrastructure. We would like to support that because it enhances efficiency.

Courting confidence

FT: You mentioned confidence. I spoke to one banker and he put it quite well. Regarding whether foreign investors who fled might return, his argument is, when I go into a Chinese restaurant, I look around and if there are Chinese people eating there, I know it's good. His argument being: a foreigner is not going to invest in the Nigerian stock market until Nigerians feel confident doing it.

AO: I do think that a lot of foreign institutional investors looked at the capital market in Nigeria as a frontier market, and looked at it as an opportunity to diversify their holdings. I do think that what happened globally impacted that because people first divested so that they could fund some of their obligations in their own markets. I don't agree with this other person about the Chinese [restaurant] because most of the people who invested in this market were actually not living in Nigeria and didn't have to visit Nigeria and they invested through funds, a number of hedge funds.

So portfolio flows in my opinion will be driven by what happens in the core G7 markets. As those markets start to recover, and they have started recovering, people will feel comfortable and confident to focus on other markets. The signals that we send as regulators about the kind of market that we will make sure that we have in Nigeria are so critical to those monies coming back. I've heard that even for some of the transactions that have come to the markets this year the participation by international investors has been higher than local investors.

People are looking at the market opportunistically because people see that the market will start to recover significantly. [Stocks] have improved by about 10 per cent already since the beginning of the year, so some people are looking at entering the market earlier than others. Of course I'm biased because I'm a regulator in this market, but I do think that [there is] the opportunity to pick up assets right now and then see the markets evolve and do well in those markets.

Fostering fixed-income

FT: Now then, the fixed income part of your plans will possibly have a far bigger economic impact [than equities]. At the moment, that is minimal.

AO: Yes, as we have discussed previously, ensuring that we have the right conditions for a fixed income market is something I consider a top priority, and the reason I consider it a top priority is because of the huge funding needs of our country. There's scope for a federal government, a state government, even the local government, as well as private sector to look to raise money so that we can be where we would like to be ideally.

FT: But they already do.

AO: Not very much. Today the sovereign bond market, which in my mind is a success story, is about a trillion naira ($7bn). That's all that there is. And what we've seen is a lot of institutional investors, particularly the pension funds, looking for credible assets given their investment policy requirement. There's been a lot of interest. In fact, all of the bonds that have been issued by the federal government have been oversubscribed. They've reopened the three-year, they've reopened the five-year, they've reopened the 20-year and all of them are oversubscribed.

The states have also been in the market, notably Lagos State which, from what I understand, has been taking the lead. Kwara State, Imo State and Niger State have also issued. I understand states like Bayelsa State, one of the states of the Niger Delta, is looking at the market. Kaduna State is looking at the market.

So there's clearly a need for the fixed income market when you look at the huge funding needs of the federal government, of the state government, and corporates as well. I do think from an issuer's point of view the all-in costs of issuing in this market are very, very low compared to any market and I do think it's a real opportunity for corporates.

FT: People do make an argument about the fees.

AO: The SEC and NSE and other regulators have worked over the recent past to make it more cost effective to issue in this market. So there was a reduction in fees in 2007, there was another reduction in 2008, and we're looking at a program of fee reduction going forward.

One of the issues that is a barrier in my opinion are the lengthy, cumbersome approval processes and within the SEC we're looking at our processes because the culture in our country has traditionally been equities driven and so the approval processes have tended to be that way. And what we're doing is to look at how to streamline the issuance approval process for fixed income transactions.

The other things that are extremely important in fixed income relate to making sure that you have hedging instruments, such that primary market dealers are focusing on their intermediation role rather than taking outright positions. We don't have a futures market that's developed. We have an over-the-counter market that has the potential to be bigger. So leveraging more the risk management instruments and hedging instruments will also support the development of our fixed income market.

As I said, the sovereign market is extremely successful. There's now a benchmark at different points of the yield curve that people can benchmark themselves off of. There are also efforts being made by our debt management office to enhance the liquidity of the sovereign bonds.

FT: But what you really want to happen is for, say, MTN, Shell, Dangote Group and whoever, to start shifting from bank borrowing, which hovers up all that bank credit, to shift that borrowing into the corporate debt market, which also gives you long-term bonds and all the advantages of that, but also frees up bank credit to do more lower level lending.

AO: Absolutely. Under the auspices of the financial sector regulatory co-ordination committee we've actually discussed it as an issue that we need to look at. And we have committed, the SEC to road-show to the telecommunication companies, the oil and gas companies, as to the value of a fixed income market.

My perception is that there's a real missed opportunity, both for issuers, for the country, for investors by not developing a fixed income market. What we want to do though is to make sure that we do it right.

I do think something that's also important, which we don't have yet in our markets, particularly for the sovereign bond market, is both repos and securities lending, which in most other markets you would expect to have for a vibrant fixed income market. My expectation is that our fixed income markets will be much bigger than our equities market, just given its contribution or the contribution of capital formation to the GDP. That's where I expect it to go.

A dispassionate view of the market

FT: Do you think it helps or hinders you that you've been out of the country for a while, coming into this job?

AO: I actually think it's a great benefit in many ways. I do think I've got the skills. I'm extremely passionate about the capital markets. I started my career in the capital markets here in 1985 and left in 1987. I've had the opportunity predominantly working in the Treasury team of the African Development Bank. And more specifically as the Group Treasurer of the African Development Bank, to invest in markets all over the world and to issue in markets all over the world as Group Treasurer. We issued across the world. Our book was predominantly in dollars but we also issued in euros, in Japanese yen.

I also do think that coming into this market at this time, I've got a very dispassionate view of the market such that if there are things that have happened in terms of selling that are improper, in terms of sending signals, I don't have the kinds of relations with those people from within the market who have operated in this market solely, or the emotional relationships. And I believe that's why the president acting on the recommendation of the minister of finance and the minister of state had asked that I be considered for this role – because of my dispassionate view. Such that I can just come in and do what is right.

I also have experience in economic development, which I think is extremely useful. Because the reason that the capital markets exist is to support the development of a nation. And I believe that where the capital markets of any country go, that's where its economy goes, and that's where the country will go.

FT: A lack of connections, it's a country built on relations that are sometimes too close – you're outside that?

AO: Absolutely. And I've got a reputation to protect. I've spent 22 years building a global reputation. And so for me what is of interest is service to my country, to make a difference. I think there's a real opportunity for us to learn from the experiences of the past. I bring my global experience to bear in learning those lessons. And making sure that we lay solid foundations for a market that contributes to the social and economic development of this country is my sole objective. And that's why I was asked to do this.